

Air NZ Limited  
Cross-Submission to the Commerce Commission on

Commerce Act 1986, Part 4

Draft report to the Ministers of Commerce and Transport on how  
effectively information disclosure regulation is promoting the  
purpose of Part 4 for Auckland Airport



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## **Auckland Airport s 56G Draft Report – Air NZ Cross-Submission**

1. The Commission published its Draft Report on how effectively information disclosure is promoting the purpose of Part 4 of the Commerce Act for Auckland Airport on 30 April. Submissions on this draft report were published on 4 April. Cross-submissions are due on 14 June.
2. The major themes in airport submissions relate to:
  - The fact that information disclosure has resulted in more, and more transparent, information is evidence that information disclosure has been effective in promoting the purpose of Part 4
  - Auckland Airport has, notwithstanding the Commission’s assertions, provided sufficient evidence to demonstrate its performance is superior across a range of measures

### **Has information disclosure been effective?**

3. NZAA claims that:

*“...there is evidence that the ID regime has been effective because:*  
*(a) Sufficient information about airport performance and conduct is available to interested parties;*  
*(b) Airports are continuing to engage in positive behaviour that was present before the transition to the Commerce Act ID regime; and*  
*(c) Where areas of concern have been identified, conduct and performance are moving closer to the Part 4 outcomes.”<sup>1</sup>*

4. Auckland Airport states that:

*“...ID regulation is fulfilling its key objective by:*  
*(a) Providing transparency around airport behaviour, decisions and performance;*  
*(b) Ensuring interested persons have access to increased amounts of high-quality information, prepared on a consistent basis over time; and*  
*(c) Facilitating more effective consultation processes between Auckland Airport and its airline customers.”<sup>2</sup>*

5. Air NZ considers that the simple availability of information and suggestions of movement towards achieving outcomes in line with the Part 4 purpose statement is not sufficient, in and of itself, to conclude that information disclosure has been effective at promoting the purpose of Part 4, particularly in respect of the key objective of limiting the ability to extract excess profits.

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<sup>1</sup> NZAA, Section 56G Review of Auckland Airport: Submission on Commerce Commission Draft Report, 31 May 2013, para. 15, p.4 (“NZAA Submission”)

<sup>2</sup> Auckland Airport, Section 56G Review of Auckland Airport – Submission on Commerce Commission Draft Report, 31 May 2013, para. 25, p.5 (“Auckland Submission”)

6. Auckland Airport appears to believe the fact that it “and its substantial customers are closer in our understanding of each others’ issues than ever before”<sup>3</sup> as evidence of the impact of information disclosure on its behaviour and decision-making. While the most recent consultation process was marked by a considerable degree of alignment on a number of issues (in part a reflection of the process leading to the price reset in 2007), this does not change the fact that on the most important issue, pricing, the positions remain significantly at odds. Auckland Airport continues to believe that it is entitled to price at a level in excess of a competitive market outcome and while it set prices at a level below that, these prices will still deliver a profit outcome that is not consistent with the Part 4 purpose.
7. Both NZAA and Auckland Airport highlight the importance of the threat of further regulation as a key part of the effectiveness of the regime. Notwithstanding this, they go on to suggest that evidence of a failure by the airports to act in a manner consistent with promoting the purpose of Part 4 should not in itself cause concern.
8. It is noteworthy that the airports continue to seek to undermine the ability of the Commission to undertake the task required of it in these s 56G reviews:
 

*“... it was never intended by lawmakers that the Commission’s WACC IM would be a hard target that airports must price to. The role of ID regulation in providing information, promoting transparency, and incentivising changes in conduct and outcomes over time is what must be assessed.”*<sup>4</sup>
9. This statement overlooks that the Ministry of Economic Development, in its advice to the Select Committee did state that “...these IM’s [for pricing principles and the cost of capital] should be used for analysis and comment by the Commission (including whether the business is earning more than WACC).”<sup>5</sup> It also ignores the intentions of Government in promoting this regulatory regime – “The key reason for providing for price and quality control, or “economic regulation”, is to counter the ability of firms that are not faced with competition or the threat of competition to charge excessive prices and/or reduce quality.”<sup>6</sup>
10. The intention of lawmakers was clearly to curb excessive profiteering by suppliers of monopoly services. This requires the Commission to make an assessment of what an appropriate level of return is and to assess expected airport returns against that. Given that the Commission has no ability to set or limit Auckland Airport’s charges or to determine the structure of charges, suggesting that the Commission’s assessment approach is akin to price control is spurious.
11. In the case of Auckland Airport the Commission has clearly demonstrated that the airport set its prices in 2012 with an expectation of achieving returns above a level commensurate with a competitive market outcome. Simply because

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<sup>3</sup> Ibid, para. 24(c), p. 4

<sup>4</sup> Ibid, para. 121, p. 27

<sup>5</sup> Commerce Amendment Bill, Report of the Ministry of Economic Development, 4 July 2008, p. 25

<sup>6</sup> Commerce Amendment Bill, Introductory Copy, p. 2

Auckland Airport believes there are “contextual factors” that warrant it achieving above-market returns (and which the current pricing regime enables it to achieve) does not mean that this is in fact the case.

12. As noted in our submission, the Commission has identified that:

*“We do not agree that we can conclude that information disclosure is effective providing it places some constraints on profit levels, and as a result prices are lower than they would otherwise be. This is because the airport might still be targeting an excessive level of profits.”<sup>7</sup>*

13. Air NZ agrees wholeheartedly with the Commission on this point and considers that if the conclusion is that airports are pricing at a level above that which could be achieved in a competitive market it is vital that the threat which is key to the effective operation of the regulatory regime is acted upon. As per our submission on the draft report the Commission’s analysis clearly indicates that Auckland Airport has set prices at a level which will result in excessive profits being extracted. Failing to acknowledge this will simply embolden shareholders to demand increased profits in the future as the regime has been shown to lack vigour. Similarly, lack of an appropriate response to other airports’ excess profit-seeking will increase the pressure on Auckland Airport to increase its own profits above the already excessive level.

### **Is Auckland Airport’s performance “superior”?**

14. Auckland Airport refers to a number of initiatives it has undertaken as evidence that it is a superior performer.

15. While not wanting to detract from the benefits accruing from initiatives at Auckland, Air NZ considers that many of these initiatives are simply standard practice at peer airports or reflect the actions of a multitude of stakeholders rather than simply actions undertaken by the airport.

16. For example, common features at airports across Air NZ’s international network include provision of GPU’s, zoning of check-in with clearer information as to where particular flights are being processed (although Auckland Airport’s inclusion of advertising on these screens does detract from the utility of the FIDS screens), and MARS stand configurations.

17. Air NZ notes also that the Airport’s APD initiative uses information which airlines are already statutorily required to provide, at their own cost, to border agencies. The additional feature of APD is the provision of information to airport operations staff and retail providers, facilitating the generation of increased commercial revenues through enhanced targeting of travellers.

18. Auckland Airport also claims that it delivers superior quality service based on its ASQ survey results and the number of awards it has won in recent years.

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<sup>7</sup> Commerce Commission, *Draft report to the Ministers of Commerce and Transport on how effectively information disclosure regulation is promoting the purpose of Part 4 for Auckland Airport*, (Draft Report), April 2013, para. E26, p. 77

There is no doubt that Auckland Airport, particularly in terms of retail experience in the international terminal, currently delivers an experience which passengers appear to appreciate. However, quality demanded by consumers cannot be separated from the price they are willing to pay.

19. Air NZ provided, as part of its submission to the Commission on its s 56G review of Wellington Airport<sup>8</sup>, detailed commentary based on our own passenger research in relation to passenger's considerations when purchasing an air ticket and their satisfaction with their journey. The key factors which travellers consider important were concluded to be:

- Price;
- Flight schedules;
- Airline service reputation; and
- On time operation and airline safety reputation

20. This conclusion is backed up by the UK Civil Aviation Authority in its recent proposal regarding economic regulation of London Heathrow airport:

*“Survey evidence suggests that the quality of the airport itself ranks significantly behind passengers’ primary concerns. These include the ease of access to the airport, the availability of airline routes, and the price of the airfare....”*<sup>9</sup>

21. As noted in our Wellington Airport submission, *“The price that [an airport] charges is a direct cost to the airline providing service. Assuming that long term, airlines can cover the cost of operations, [airport] prices will be reflected in the price that the customer pays.”*<sup>10</sup> Higher prices inevitably impact demand, with a resulting negative impact on consumer welfare.

22. Notwithstanding Auckland Airport's claims otherwise<sup>11</sup>, Air NZ's experience of competitive markets is that efficiency gains are inevitably reflected in market prices. “Superior quality” should not be seen as an automatic rationale for increasing prices above an appropriate level. As highlighted by the research discussed above, price is a defining factor for the majority of consumers. In the absence of an ability for consumers to make appropriate price-quality trade-offs, the relentless pursuit of “higher quality” will do nothing more than restrict the market.

23. Auckland Airport also points to its route development initiatives as evidence of its superior performance and efficiencies, including the *“at least 10.8% of FY12 volumes... associated with initiatives Auckland Airport has been involved in...”*<sup>12</sup>. During consultation Auckland Airport provided very high

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<sup>8</sup> Air NZ Limited, Submission to the Commerce Commission, Commerce Act 1986, Part 4, Section 56G Review, 29 June 2012, section 5.7.5, pp. 50-52 (“Air NZ Wellington Submission”)

<sup>9</sup> Civil Aviation Authority, CAP 1027 Economic Regulation of Heathrow from April 2014: initial proposals, April 2013, para. 17, pp. 7-8

<sup>10</sup> Air NZ Wellington Submission, para. 240, p.51

<sup>11</sup> See for example, Auckland Submission, para. 41(c)-(d), p. 9

<sup>12</sup> Ibid, para. 206, p.45. Emphasis added.

level information which it purported to show that its route development initiatives provided significant payback and were a considerable benefit to airlines. Air NZ remains unconvinced by Auckland Airport's claims as to the level of influence its activities had on market performance over PSE1. What appears to be missing from Auckland Airport's analysis is an assessment of the impact of airline activities in terms of innovation and pricing, and indeed the level of airline profitability during this period – potentially reflecting a deliberate strategy by airlines to reduce fares to stimulate markets. For example, this period saw the introduction by Air NZ of its "Seats to Suit" innovation in short-haul international markets, providing consumers with greater choice of product to suit their particular service and cost requirements.

24. Air NZ urges the Commission not to over-estimate the impact of airport marketing initiatives on airline network planning and service definition decisions. Market development and growth is a function of a myriad of considerations at both the consumer and supplier level. Auckland Airport's claims that development of the Chinese market is an indication of the success of its initiatives should not be taken simply at face value.

### **Concluding remarks**

25. Air NZ considers this s 56G review process to have been a comprehensive and worthwhile review of Auckland Airport's 2012 pricing decision. However, and as covered in detail in our initial submission on the Draft Report, the Commission risks undermining this work, and the regime itself, if it continues to focus its analysis on the upper limit of what it has determined to be the range of appropriate returns. Air NZ reiterates the points made in that submission and urges the Commission to fully incorporate the analysis undertaken by NZIER in its final report.